

ON DECK FOR WEDNESDAY, AUGUST 7

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	08/07	07:00	MBA Mortgage Applications (w/w)	AUG 2	--	--	-1.4
US	08/07	15:00	Consumer Credit (US\$ bn m/m)	Jun	--	16.5	17.1

KEY POINTS:

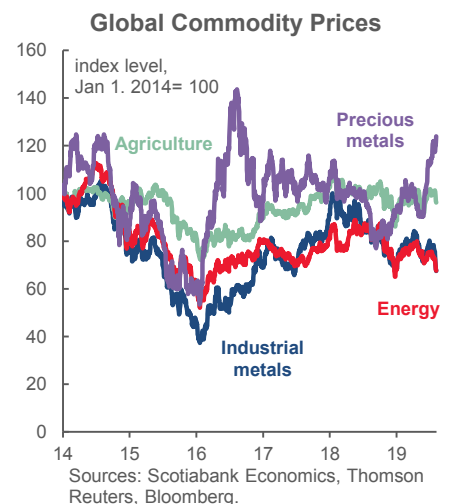
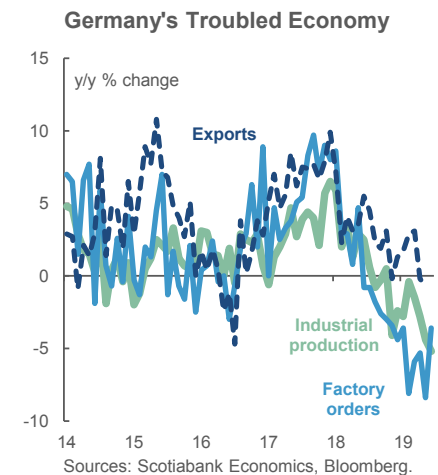
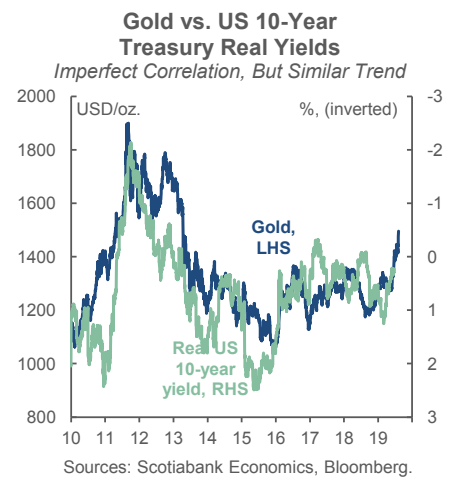
- Risk aversion sweeps through markets on trade and rate fears
- Rate cuts and commodity hits...
- ...are dragging equity financials and materials lower
- Asia-Pacific CBs fan currency wars...
- ...as NZ\$ plunges on more dovish than expected RBNZ...
- ...rupee drops as RBI exceeds cut expectations...
- ...and the BoT cuts...
- ...with BSP likely to follow tonight
- Canada curve heaps on BoC cut bets
- German industrial output sinks to late 2016 level
- Brazilian real slips after another weak retail print
- Fed's Evans: is Fed-speak turning more opaque?
- Tariffs are costing the US Treasury
- US to auction 10s
- Canada to auction 2s

What relatively few developments there are to consider this morning are generally dovish in nature. German industrial output fell in June to its lowest level since the end of 2016 with further downside likely as global trade tensions escalate. Trade remarks by Trump are unlikely as he travels to El Paso and Dayton to face the music, but he's attacking the Fed again versus looking in a mirror. Three regional Asia-Pacific central banks eased policy overnight as global central bankers fixate upon trade worries (see below). Markets are trusting PBOC guidance that ample liquidity exists to merit skipping repo operations and the yuan won't be allowed to fall with the latest fixing just under 7 to the dollar, perhaps having learned nothing in 2015 about trusting the state's currency guidance. The Chicago Fed's Evans will be watched for whether he agrees with the less dovish comments from Bullard yesterday, but perhaps all Fed-speak should now be faded (see below). The US and Canada only face debt auctions amidst otherwise empty calendars today.

- Safe haven crosses like the USD, yen and Swiss franc are again picking up momentum. The euro is holding its own while the biggest decliners are the NZ\$ (RBNZ, see below), rand, real (retail sales, see below) A\$ (RBNZ spillover) CAD and sterling.
- Markets are piling on BoC rate cut bets after a trio of Asia-Pacific central banks eased overnight. This has the Canadian front-end outperforming most others except New Zealand's, with Canadian yields down 8–10bps across the curve. All Canadian yields are negative in real terms and all Canadian

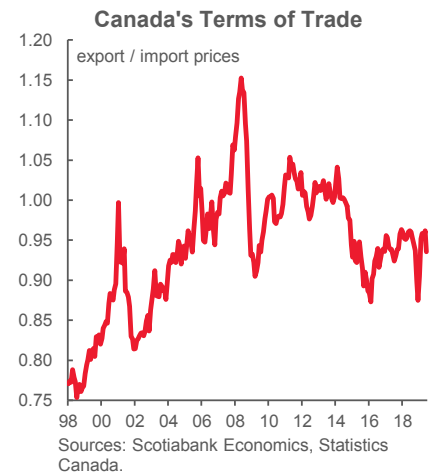
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yields are well under the BoC's 1.75% overnight rate, pressuring the BoC to ease soon or tighten financial conditions as an outlier. US Treasuries are bull flattening with 2s down 7bps and 10s down 11bps. Gilts and EGB yields are down by 7–10bps in 10s.

- Oil prices are down by almost two bucks in terms of both Brent and WTI ahead of the US government's report on oil inventories at 10:30amET. Gold is up US\$27 to US\$1498 which is the highest since early 2013 as real rate expectations tumble (chart 1). The Canada Western Select oil price proxy for western Canada's output is hovering just beneath US\$40 per barrel and remains \$16 below the peak in April. Domestic production cuts and other idiosyncratic drivers have kept the discount to WTI due to higher refining costs fairly stable around US\$12–13 per barrel. At the margin, this has not yet dragged down Canada's terms of trade, but the data goes only to June (chart 2); by contrast, the Thomson Reuters/CRB core commodities index is showing the China pain trade by sinking toward the lowest levels of the 2016–19 period such that Canada's terms of trade faces downside risk in subsequent releases. The decline in the terms of trade and the effects on domestic incomes was a major reason the BoC cut twice in 2015.
- US equity futures are plunging again with declines of 1%+ across exchanges. TSX futures are down by less, about 1/2% so far. European cash markets are mixed with London is slightly lower, Paris and Frankfurt are slightly higher and Italy is down by almost 1%. The weakest parts of the FTSE100 are financials and materials while other sectors are rallying. Asian markets fell on average including ¼% drop in Tokyo, little change in the Hang Seng, and ¼–½% declines in mainland China while Seoul was down ½%.



Three Asia-Pacific central banks collectively cut rates by more than expected and one more might cut tonight. Trump is fanning flames at the Fed again by citing it as evidence they must cut “bigger and faster” rather than correctly observing that the reason central banks are easing is because of Trump's disastrous trade policies that are derailing global trade. He incorrectly demands that the Fed should end quantitative tightening ‘now’ when a) they were on that path by September before b) doing so last week and effective August 1st.

1. RBNZ: The Reserve Bank of New Zealand cut its official cash rate by 50bps to a record low of 1%. Eighteen of twenty-one forecasts expected a quarter point cut and three expected no reduction. Markets were also caught flat-footed, as the yield on the NZ two year bond plunged by about 15bps overnight. The statement ([here](#)) discussed the debate about cutting by 25bps versus 50bps and why they leaned toward larger easing. Governor Orr's press conference added to the dovish market response including when he stated “It's easily within the realms of possibility that we might have to use negative interest rates” but that the bigger than expected move reduces such chances.

2. RBI: The Reserve Bank of India also eased by more than expected. The repurchase rate was cut by 35bps to 5.4%. Consensus expected a ¼ point cut with only one expecting a larger 50bps move and two expecting no cut. The statement ([here](#)) explained the odd 35bps move as a compromise between ¼ and ½ point camps.

3. BoT: The Bank of Thailand unexpectedly cut by 25bps. Only two out of 29 forecasters took a chance in favour of easing that markets had significantly anticipated especially after the recent deterioration in US-China trade developments. The statement ([here](#)) struck a data dependent tone “in deliberating appropriate monetary policy going forward.” Offsetting earlier strength in the Thai baht is among the policy imperatives as Thailand sounded relatively hawkish compared to other peers until now.

Bangko Central ng Pilipinas will probably come through with its own ¼ point rate cut tomorrow morning.

German industrial production fell by 1.5% m/m (-0.5% consensus) and the prior month was revised downward to +0.1% m/m from 0.3%. The level of industrial output sits at its lowest since December 2016. Further downside is likely since, being June data, it does not yet move into covering the period during which trade tensions further escalated. That will probably hit the August-onward data starting two rounds from now such that as bad as it is, today's figures are stale. Exports for June are due out on Friday and will complete the monthly tally of bleak industrial and trade figures for the German economy (chart 2).

The Brazilian real slightly depreciated after another soft retail sales report this morning. Sales increased by only 0.1% m/m (consensus 0.5%) and were revised up by only a tick to 0% m/m in May after a 0.4% drop in April. At the margin, the consumer data slightly reinforce the BCB's dovish stance reflected in last week's cut and the minutes to that meeting with guidance pointing to further reductions.

Canada auctions 2s at 12pmET.

UNITED STATES

Chicago Fed's Evans hosts a media breakfast in Chicago this morning (8:30CDT, 9:30amET) and the question is whether he will back up the relatively moderate stance Bullard delivered yesterday when he implied he's still fine with just one more cut this year. The challenge in reading Fed speak now is whether they learned not to set themselves up to get picked off by Trump in openly stating they'll cut more on trade policy risks in one form of explanation or the other. Bullard's words might have been more cautious for that reason after Powell revealed his book and reaction function to Trump. It may well be that all Fed speak is transitioning toward being much more opaque on trade policy implications to rates.

Trump's tariffs are costing enough to more than offset tariff revenues received by the US Treasury as protectionists get a modern day lesson on what felled mercantilist thinking ages ago. Sure enough, tariff revenues have reflected what Trump has done by hiking tariffs on China (chart 4). But chart 2 illustrates the offset from two rounds of aid packages to farmers in July 2018 and May 2019 that face lags in sending out the payments (e.g. USDA update of its May announcement in July [here](#)). Already the US\$32 billion in year-to-date tariff revenues are being offset by US\$28 billion in just farm aid so far. This is robbing Peter to pay Paul while basically putting hard working US farmers on welfare. Further, as an offset to Trump's 10% pending tariff on US\$300 billion of Chinese imports that is planned for September 1st, additional farm support has been promised by Trump now that China is ceasing purchases of all US agricultural goods. There are also other offsets to Treasury's tariff receipts and other incidence effects:

For one thing, paying higher tariffs results in part in higher cost of goods sold by US businesses which lowers profit all else equal and hence lowers corporate tax receipts on those profits. Estimating this effect is difficult because of uncertain incidence effects.

For another, this assumes imports from China (and exports to China) will be unaffected by the tariffs whereas global trade is retrenching and this is likely to dampen Treasury's tariff receipts on lower volumes.

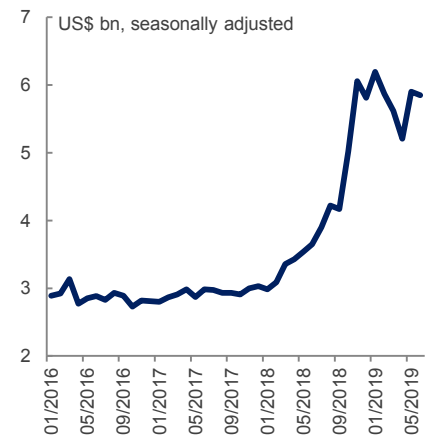
Further, not since the days of mercantilism have we heard a major power argue that tariffs generate bounties; rather, they get paid by others, like businesses and consumers.

Additionally, tariffs and trade wars have cost global and US economic growth and dampened Treasury tax receipts compared to what they would have otherwise been.

On net, stating that the US Treasury is generating net tariff bounties is as false a claim as when European powers of yesteryear false believed the impact upon revenues represented a bounty of riches.

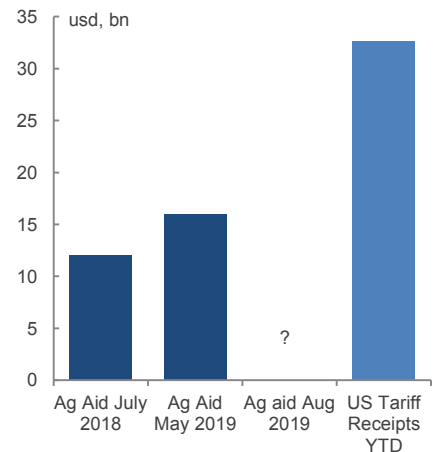
The US auctions 10s at 1pmET.

US Treasury's Tariff Receipts



Sources: Scotiabank Economics, Bloomberg.

Direct Impact of Trade War on US Treasury



Source: Scotiabank Economics.

Fixed Income	Government Yield Curves (%):												Central Banks	
U.S. CANADA GERMANY JAPAN U.K.	2-YEAR			5-YEAR			10-YEAR			30-YEAR			Current Rate	
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk		
	1.52	1.59	1.87	1.44	1.51	1.83	1.61	1.70	2.02	2.14	2.23	2.53	Canada - BoC	1.75
	1.28	1.35	1.54	1.13	1.21	1.45	1.15	1.24	1.47	1.42	1.50	1.69	US - Fed	2.25
	-0.85	-0.82	-0.78	-0.82	-0.77	-0.72	-0.60	-0.54	-0.44	-0.14	-0.04	0.12		
	-0.23	-0.22	-0.20	-0.28	-0.27	-0.24	-0.19	-0.18	-0.15	0.28	0.31	0.35	England - BoE	0.75
0.43	0.43	0.44	0.31	0.33	0.38	0.45	0.52	0.61	1.10	1.19	1.32			
CANADA GERMANY JAPAN U.K.	Spreads vs. U.S. (bps):													
	-24	-24	-33	-30	-30	-38	-47	-47	-54	-72	-73	-83	Euro zone - ECB	0.00
	-237	-240	-265	-226	-229	-254	-221	-224	-246	-228	-227	-240	Japan - BoJ	-0.10
	-175	-181	-208	-171	-178	-206	-180	-189	-217	-186	-192	-217		
	-109	-116	-144	-113	-118	-145	-116	-119	-140	-104	-104	-121		
Equities	Level						% change:							
	Last	Change					1 Day	1-wk	1-mo	1-yr				
S&P/TSX	16149	-122.2					-0.8	-1.9	-2.4	-0.8				
Dow 30	25558	-471.7					-1.8	-4.9	-5.1	-0.3				
S&P 500	2882	37.0					1.3	-3.3	-3.6	0.8				
Nasdaq	7739	-93.8					-1.2	-5.3	-5.2	-1.8				
DAX	11601	33.2					0.3	-4.8	-7.7	-8.3				
FTSE	7171	-0.9					-0.0	-5.5	-5.1	-7.1				
Nikkei	20517	-68.8					-0.3	-4.7	-5.7	-9.5				
Hang Seng	25997	20.8					0.1	-6.4	-9.7	-8.0				
CAC	5246	11.1					0.2	-4.9	-6.2	-5.0				
Commodities	Level						% change:							
WTI Crude	51.76	-1.87					-3.5	-11.6	-10.0	-25.2				
Natural Gas	2.11	0.00					0.1	-5.3	-12.6	-27.0				
Gold	1499.45	25.05					1.7	6.1	7.2	23.8				
Silver	16.39	-0.10					-0.6	-0.4	7.7	6.8				
CRB Index	169.10	-1.44					-0.8	-5.3	-6.5	-13.1				
Currencies	Level						% change:							
USDCAD	1.3328	0.0047					0.4	1.0	1.8	2.1				
EURUSD	1.1226	0.0027					0.2	1.4	0.1	-3.2				
USDJPY	105.72	-0.7500					-0.7	-2.8	-2.8	-5.1				
AUDUSD	0.6737	-0.0024					-0.4	-1.6	-3.4	-9.2				
GBPUSD	1.2145	-0.0026					-0.2	-0.1	-3.0	-6.1				
USDCHF	0.9719	-0.0045					-0.5	-2.2	-2.2	-2.4				
Next Meeting Date														
													Canada - BoC	Sep 04, 2019
													US - Fed	Sep 18, 2019
													England - BoE	Sep 19, 2019
													Euro zone - ECB	Sep 12, 2019
													Japan - BoJ	Sep 19, 2019
													Mexico - Banxico	Aug 15, 2019
													Australia - RBA	Sep 03, 2019
													New Zealand - RBNZ	Sep 24, 2019

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing. While this source is believed to be reliable, Scotiabank cannot guarantee its accuracy.

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